Statement of the U.S. Chamber of Commerce

ON: FY2012 ADMINISTRATION BUDGET PROPOSALS

TO: THE HOUSE COMMITTEE ON WAYS & MEANS

DATE: FEBRUARY 15, 2011

The Chamber's mission is to advance human progress through an economic, political and social system based on individual freedom, incentive, initiative, opportunity and responsibility.

The U.S. Chamber of Commerce is the world's largest business federation, representing the interests of more than three million businesses and organizations of every size, sector, and region.

The Chamber's members are businesses of all sizes. Our membership consists of small businesses with 100 or fewer employees, 70 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are cognizant of the problems and challenges facing the business community at large.

Besides representing a cross-section of the American business community in terms of number of employees, the Chamber represents a wide management spectrum by type of business and location. Each major classification of American business -- manufacturing, retailing, services, construction, wholesaling, and finance – is represented. Also, the Chamber has substantial membership in all 50 states.

The Chamber's international reach is substantial as well. It believes that global interdependence provides an opportunity, not a threat. In addition to the U.S. Chamber of Commerce's 105 American Chambers of Commerce abroad, an increasing number of members are engaged in the export and import of both goods and services and have ongoing investment activities. The Chamber favors strengthened international competitiveness and opposes artificial U.S. and foreign barriers to international business.

Positions on national issues are developed by a cross-section of Chamber members serving on committees, subcommittees, and task forces. More than 1,000 business people participate in this process.

INTRODUCTION

The Chamber thanks Chairman Camp and Ranking Member Levin for the opportunity to comment on the tax proposals contained in the Administration's FY2012 budget (the "Greenbook"). The Chamber is immensely disappointed, both with the proposals included in the Greenbook and that the Greenbook makes no mention of tax reform. While we are disappointed with the included proposals, which largely are a rehash of prior year Greenbooks, we are even more so with the fact that none are coupled with true fundamental tax reform. Despite months of the Administration touting an interest in tax reform, they completely fail to mention the issue of fundamental tax reform, and, instead, seek to impose over a trillion dollars in new taxes on the business community.

The Chamber believes that as the Committee considers policies to drive job creation and economic growth and considers fundamental federal tax reform, it should firmly reject the piecemeal approach contained in the Greenbook and seek to undertake comprehensive tax reform to foster growth, competitiveness, innovation, and job creation. As other countries, and even individual states within our own borders, move to adopt tax policies that foster growth, competitiveness, and innovation, these proposals generally would move the federal tax code[1] in precisely the opposite, and wrong, direction.

IN GENERAL

The Greenbook, in large part, repeats prior year tax proposals of this Administration, levying onerous tax increases on businesses of all sizes and picking winners and losers, while omitting pro-growth tax policy. It levies over a trillion dollars of new business taxes, while providing only $116 billion[2] of tax cuts, $106 billion of which is comprised of one incentive – making the research and development (R&D) tax credit permanent – which generally is already renewed on an annual basis.

TAX INCREASES

Individual and Small Business Tax Hikes

As in prior years, the Greenbook includes significant tax increases on upper income individuals, totaling over $1 trillion. These proposals fail to recognize that these increases hit the most successful U.S. small businesses that pay taxes at individual tax rates, hindering their ability to grow and create jobs.

Our tax system is already highly progressive (in 2008, the top 1% of the income distribution controlled about 20% of income and paid almost 40% of federal income taxes). Yet, the Greenbook proposes an even more punitive system on those who save, invest, and create jobs. It proposes increasing the top marginal tax rates, reducing or

---

[1] All references to the "code" are to the Internal Revenue Code of 1986, as amended.
[2] All revenue estimates are for 10 year periods and are provided by OMB.

eliminating itemized deductions, limiting the rate at which the remaining deductions could be taken, and raising the tax rate on capital gains and dividends.

Quite simply, the Committee cannot ignore the negative impacts of these tax increases and must reject such policies in both the near and long term. Over the past 30 years, the number of pass-thru businesses – sole proprietorships, S-corporations, LLCs and partnerships – has nearly tripled. Last year, the Joint Committee on Taxation determined that a substantial share of new revenue (50% for the increase in the top two rates) was directly attributable to the income reported for pass-thru businesses by their owners. In other words, small businesses, the backbone of the U.S. economy and America's jobs creators, would bear a substantial portion of these higher taxes.

Further, according to the nonpartisan Tax Foundation, about 39% of the tax increase on upper income taxpayers proposed in last year's Administration budget would have come from business income. It is fair to presume that this year's proposals would have similar adverse impacts on small business job creators.

The Chamber believes these burdensome tax increases represent poor policy, in both the short term and long term. Further, the lessons of such proposals should be two-fold as the Committee considers fundamental tax reform. First, it is critical to recognize the significant numbers of entities who remit taxes under the individual Code, and, thus, careful consideration must be given to any reform that addresses the corporate tax rate without properly considering individual rates. Second, given the significant and increasing numbers of these pass-thru entities, the Chamber believes proposals, such as these tax increases, must be rejected, as they thwart the growth of the very businesses which are the backbone of our economy.

Other Business Tax Increases

Also as in prior years, the Greenbook includes tax increases on larger business entities, totaling $357 billion, achieved by, among other things, double taxing the profits American worldwide companies earn overseas, levying punitive new taxes on traditional energy producers and reinstating Superfund taxes, repealing longstanding accounting practices, and taxing the carried interest in partnerships as ordinary income.

International Taxation

The Greenbook once again proposes to double tax the profits American worldwide companies earn abroad, by curtailing deferral, limiting foreign tax credits, and attacking the treatment of intangibles. Despite the fact that the President's own fiscal commission report states that our system of taxing foreign source income is against the norm, and "[t]he current system puts U.S. corporations at a competitive disadvantage against their foreign competitors," the Greenbook contains these $129 billion of international tax increases that threaten to put American companies at even greater competitive disadvantage.

The Chamber urges the Committee to reject these proposals and, instead, as it considers fundamental reform, consider ways to level the playing field for American businesses, such as transitioning to a territorial tax system. The Chamber believes any changes to international tax policy should make American companies more competitive, drive job creation, and stimulate overall economic growth.

Punitive Energy Taxes

The Greenbook also suggests large and onerous tax increases on traditional energy producers, totaling over $46 billion. This represents not only continued, but increased, attacks on oil and gas companies as well as coal companies. Further, in addition to industry punitive taxes, these companies also face tax hikes in the form of last-in, first-out (LIFO) repeal and changes to the dual capacity rules. All of these tax increases result in increased energy costs and decreased energy security.

Once again, these proposals punish industries such as oil and gas, who already face some of the highest effective tax rates of any industry sector and who create millions of high-paying jobs. Further, the Greenbook justifies these increased taxes on traditional energy sources to pay for "clean" energy benefits. The Chamber strongly urges the Committee to reject tax policies such as this which preference one industry or sector to the detriment of another. Instead, the Chamber suggests the adoption of policies that could benefit broader sections of the entire business community, such as more efficient cost recovery rules or increased research and development incentives.

Changes to Longstanding Inventory Accounting Methods

In addition to the above tax increases, the Greenbook once again proposes repeal of longstanding accounting methods, solely to raise tax revenues. For example, the Greenbook, as in prior years, would repeal LIFO to raise $53 billion. The Chamber opposes the repeal of LIFO accounting as it would result in a punitive, retroactive tax increase for businesses, placing significant cash constraints on them and limiting their ability to manage inflation. Companies would have to record illusory profits on their books, when no economic activity has occurred that would justify recording any profits.

In addition to the repeal of LIFO, the Greenbook once again proposes repeal of the lower-of-cost-or-market (LCM) and subnormal goods accounting methods to raise $8 billion. The Chamber opposes the repeal of these accounting methods as they provide an important cushion during economic downturns. Without these methods, businesses are precluded from recognizing real economic losses in the year of loss, and, rather, must wait until disposal of inventory. Further, any recovery in the value of the inventory in a subsequent year is not lost; rather, the business will recognize a larger amount of taxable income in the year the inventory is sold.

The repeal of these accounting methods originally was proposed as revenue offsets for unrelated initiatives. As the Committee considers short term policies and fundamental reform, the Chamber urges it to reject changes solely sought to raise revenue without consideration for the wide range of industries and businesses of all sizes which would be adversely impacted by these changes.

Changes to Investment Partnerships

To raise another $15 billion, the Greenbook would tax "carried interest" – capital gains paid to managers of investment partnerships – as ordinary income. The Chamber believes that taxing carried interest as ordinary income would deter economic activity, reduce credit flow, and stifle job creation. Further, changing this longstanding law ignores the fact that state pension funds, charitable nest eggs, and universities rely on these partnerships and could face funding shortfalls if this tax hike drove talented management capital into other fields.

Thus, as the Committee considers changes to tax policy, the Chamber urges it to seriously consider both the direct and indirect ramifications of these changes on the economy before adopting policies such as those described above.

PRO-GROWTH TAX INCENTIVES

While the Greenbook is full of tax increases, it provides little in the way of tax incentives to help businesses grow. As noted above, in contrast to the over one trillion dollars in new taxes businesses can expect to face, they would see only $116 billion of tax cuts.

Small Businesses and Individual Incentives

For small businesses, the Greenbook contains little in the way of broadly applicable incentives. Summing barely $10 billion in total small business tax cuts, the Greenbook proposes eliminating capital gains taxes on small businesses, providing only $5 billion in tax incentives. Further, it provides for small regional incentives, such as extending and expanding the new markets tax credit, which adds only another $1.8 billion in incentives.

The Chamber believes that the impact of these provisions is extremely limited. For example, the small business capital gains incentive is diminutive, partially due to its applicability only to the limited number of small businesses operating in C corporation form. The Chamber believes that as the Committee considers proposals in the context of fundamental tax reform, it should avoid narrow incentives which are of value to only one industry, sector, or geographic area. Instead, it should seek policies which broadly benefit the widest possible cross-sections of individuals and businesses, such as the full repeal of the onerous 1099 reporting requirements.

General Business Incentives

The Chamber supports the inclusion of the proposal to make permanent the research and experimentation (R&D) tax credit. Longstanding Chamber policy provides that research and development incentives should actually be more expansive, for example, that research and development expenses should be deductible in the year incurred and that a credit as high as 25% credit for increases in research expenditures should be allowed.

As the Committee considers both short term policies and fundamental tax reform, the Chamber believes that it must pay close attention to how taxes impact innovation. The United States continues to lag behind other countries in its treatment of research and development costs. Thus, the Chamber recommends that the Committee seek policies that encourage businesses to conduct research and development within the United States and locate the intellectual property developed as a result of that research within our borders.

Conclusion

The Chamber appreciates the opportunity to comment on the tax proposals contained in the Greenbook. We believe that the fact that the Administration proposes to use all of these tax increases in a piecemeal uncoordinated fashion will actually make it harder to do fundamental tax reform if and when Congress seeks to do so. This piecemeal approach will decrease competitiveness, hurt job creation, and quash economic growth; should Congress undertake fundamental reform it should be comprehensive and should seek to foster growth, competitiveness, innovation, and job growth. We look forward to working with Congress and the Committee to develop tax policies that promote growth and encourage investment in the United States.